The rainbow at the end of the storm

Opportunities abound across the continent for international reinsurers prepared to take a long-term view and invest the time and resources required to support the growth of the African insurance industry

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Rainbow: Africa presents challenges to reinsurers but will reward those with a long-term plan

A new political dynamism evident in many African countries today is providing the foundation for strong social, economic and ecological development in the sub-Saharan region, where responsible governments are taking over in an increasing number of countries and these government are being monitored by an active civil society.

The sub-Saharan Africa region comprises 49 of Africa's 54 states and in 2010 sub-Saharan Africa was home to more than 853 million people. This region has the highest population growth in the world. It is estimated it is likely to treble by the end of the 21st century, so one in three people on our planet will live in Africa.

Since 2010, the sub-Saharan economies have consistently ranked among the world's fastest growing, with 4.6% regional GDP growth in 2015 and predictions of 5.1% by 2017. At least six African countries now rank among the 10 fastest-growing national economies in annual World Bank reports.

Large infrastructure projects and industrial facilities for both consumer goods and natural resources continue to raise finance successfully for new construction and expansion projects as foreign investors continue to recognise these opportunities.

Private investors

Over the past decade, private investors have committed more total funds to Africa than foreign governments or international aid agencies, with foreign direct investment in sub-Saharan Africa growing 50% to $61bn in 2014, making the region the fastest growing in the world. The sub-Saharan insurance market (excluding South Africa) is largely underdeveloped, with low penetration of financial products into the wider population. Product offering is normally plain vanilla, lacking innovation in both design and distribution.

In 2013 the total value of Africa's insurance premiums was estimated at $70bn, representing a global market share of 1.5%. South Africa accounted for nearly 74% ($51.6bn) of the total premiums, with the other 53 countries contributing only $18.3bn, which is only 0.4% of the global insurance market.

Opportunities abound across the continent for international reinsurers prepared to take a long-term view and invest the time and resources required to support the growth of the African insurance industry.

Through significant population growth, rising incomes and low penetration of insurance products, sub-Saharan Africa offers the global reinsurance market access to quicker and easier premium growth compared to a saturated and overtraded global market.

Reinsurer challenges

With any opportunity comes challenges and Africa has its own fair share of challenges for any reinsurer looking to participate.

With the downturn in emerging markets Africa has experienced a serious devaluation of local currencies and liquidity issues in obtaining hard currencies to pay for international reinsurance premiums. This was driven, mainly, by the commodity price downturn and China's reduced demand for Africa's natural resources.

South Africa has been threatened with sovereign downgrades by rating agencies, creating low investor confidence which has reverberated through the region.

Local markets are relatively small and over the past 15 years we have seen an explosion of new market entrants. This has resulted in an abundance of undercapitalised firms, leading to excessive competition on price rather than service, pushing premiums below sustainable levels and eroding consumer trust.

Regulators tend to be inadequately empowered to enact market reform or enforce market regulation. They have been mandated by their governments to retain premiums locally through the creation of state-owned reinsurers or prohibitive legislation, limiting the free flow of risk spreading.

Support services to the insurance industry, such as professional risk engineers, surveyors and loss adjusters, have not been developed and these resources need to be imported from countries such as South Africa and the UK.

Record-keeping and market data tends to be incomplete or inaccurate, with no international standard of accounting principles and reserving methodologies.

African insurance markets are largely imbalanced both in terms of net retained market premiums versus risk exposure and overall market size versus loss exposure potential.

Reinsurers willing to embrace and address these challenges should begin by demonstrating respect for local markets, laws and legislation by taking the time to understand and comply with them. They should also invest time and resources in training local people and the development of the next generation of insurance professionals.

Africa has its own unique challenges which require hard work, dedication and commitment over a long period of time to realise the rewards. To be successful on the continent takes a desire to succeed with an open-minded, can-do attitude to problem solving, which is often more important than the financial resources committed to any project. ■

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Specialty lines business can thrive in Africa

The continent's specialty lines insurance market is largely untapped and there are significant opportunities for insurers willing enter the region

Donald Dinnie and Raynold Tlhavani
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As the insurance market in Africa develops, more difficult and unusual risks will increasingly be written.

However, for any insurer wanting to tap into the African market, it is crucial to be mindful that Africa – the planet's second-largest continent – is a diverse, fast-developing place of 54 countries, each of which has its own insurance laws, protocols, practices and challenges.

African countries have insurance and financial services legislation in place, which regulates the insurance market, and a typical requirement is the placing of insurance business with locally licensed insurers. It may be advisable for a foreign insurer to partner with locally registered insurers that know the market. The regulations usually also require a percentage of the business to remain in the country or for the insurer to conclude a reinsurance agreement. The legislation may also require the external insurer to offer the product as reinsurance.

In addition to the courts, some countries have financial services ombudsmen, which serve as informal dispute resolution forums in insurance disputes. The decisions of the ombudsmen are normally binding on the insurer but not the insured, as most locally licensed insurers have agreed to abide by the rulings of the ombudsmen.

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Proceedings before the various ombudsmen's offices are informal, with the ombudsmen playing the role of a mediator as opposed to a judge. Therefore, some of the rulings are based on equity and not on a rigid application of principles of law.

Foreign investment

Although foreign investment is welcome in most African countries, there are conditions in some African countries that require a specified percentage of ownership or employment for citizens before a foreign investor would be allowed to establish a business. The rules governing foreign investment are aimed at addressing previous inequalities. However, these rules tend to be enforced differently from country to country.

It is therefore very important to include choice of law and dispute resolution clauses in insurance policies. In the event of a dispute a provision that the dispute should first be referred to arbitration, for instance, could result in a speedy resolution of the dispute for the insurer and the insured.

Relatively speaking, Africa has been spared catastrophic natural disasters. However, war risks, political risks and expatriate operational risks remain high in some parts of the continent. In addition, most African countries have legislated progressive labour laws, which have resulted in a proliferation of labour unrest in some countries.

Cyber criminal activity, including hacking, which has been on the rise internationally, is also prevalent in Africa. It is therefore important to bear in mind these attacks can have far-reaching consequences for both insurers and insureds in an environment where the support systems and other solutions to redress the impact of a cyber attack are not as accessible as they are in the more developed regions of the world. ■

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Solving the capital conundrum

Nigerian National Petroleum Corporation: the corporation says it lost $1.3bn last year as a result of the collapse in the price of oil

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Nigerian insurers, despite their relatively large capital holdings and historical low outstanding debt levels, are coming under pressure from the country's over-reliance on oil at a time of plummeting commodity prices

Deniese Imoukhuede
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Nigeria's over-reliance on oil has resulted in its recent currency woes and reflects a source of mounting concern relating to its economic prospects. This comes as expansion in the country's GDP is being affected by uncertainties surrounding the economic activity of its significant trading partner, China, and the impact of the US Federal Reserve board's tightening monetary policy on capital outflows.

Other factors include currency devaluation pressures and vulnerabilities on the domestic front, particularly with regards to heightened security threats.

Nigeria's oil dependence represents approximately 75% of consolidated budgetary revenues and 90% of the country's exports. To defend its currency and stabilise conditions, the government has implemented capital controls with the purpose of curbing the US dollar supply, while banning the import of certain items to support the diversification of the country's industries into the non-oil sector.

Low level of debt

To date, AM Best-rated insurers in Nigeria have shown stability in their rating fundamentals, in spite of underlying difficulties in the operating environment. Risk-adjusted capitalisation remains at strong levels, mostly owing to companies' large and under-used capital bases relative to their underwriting risk exposures.

Additionally, balance sheet strengths continue to be supported by a high-quality reinsurance panel and, in some cases, strengthened reserve provisions, owing to mounting inflationary pressures.

The "No premium, no cover" legislation, which prohibits the provision of insurance protection unless the premium is paid in advance, also continues to ensure a low level of outstanding debtors on balance sheets, despite the difficulties faced by consumers with regards to their cashflows.

However, there is downside potential for Nigerian insurers further ahead. In particular, with oil prices remaining low and the need for government spending cuts to cap the budgetary deficit, the amount of insurable risks available is likely to diminish as insurance demand wanes. This will constrain real term growth prospects for the sector, particularly for insurers that maintain a high weighting of oil and gas risks within their insurance portfolios.

Likewise, for insurers expanding into the retail segment, the increasing levels of unemployment and inflation will reduce consumers' spending power, with many viewing insurance protection as a non-essential expense. Rising claims experience is also expected because of a higher frequency of fraudulent claims, as consumers seek to take advantage of their insurance protection in a difficult economic environment.

Material exposed

Insurers' balance sheet strength is also susceptible to deterioration as a result of their investment strategies, which are materially exposed to the local banking sector. Nigeria's financial institutions maintain significant exposure to the oil and gas industry and are suffering from liquidity problems as a result of the central bank's restrictions on the US dollar supply.

As a result, insurers and reinsurers are adjusting their investment policies from holdings of cash, deposits and fixed income securities into privately held investments and property assets. AM Best believes this shift in strategy has higher capital implications within its financial strength assessment.

Although insurers are maintaining their policies to match their foreign currency liabilities with foreign currency assets, the depreciating exchange rate is expected to result in companies facing difficulties in maintaining sufficient liquidity levels, as inflationary effects are likely to result in companies needing to convert more original currency to meet their foreign-denominated asset/liability positions.

Yet despite the high level of volatility in the insurance and financial markets, the significant capital buffers inherent in the risk-adjusted capitalisation of AM Best-rated Nigerian insurers is expected to absorb the near-term effects of the country's heightened country risk. ■

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